Elbit Systems Ltd.
Management's Report
For The Quarter Ended March 31, 2004

This report should be read together with the Company's unaudited financial statements for the quarter ended March 31, 2004, the Company's audited consolidated financial statements and related notes for the year ended December 31, 2003, the Company's management report for the year ended December 31, 2003 and the Company's Form 20-F for the year ended December 31, 2002, filed by the Company with the U.S. Securities and Exchange Commission and with the Israeli Securities Authority.

Forward looking statements with respect to the Company's business, financial condition and results of operations in this document are subject to risks and uncertainties that could cause actual results to differ materially from those contemplated in such forward looking statements, including, but not limited to, product demand, pricing, market acceptance, changing economic conditions, risks in product and technology development, the effect of the Company's accounting policies as well as certain other risk factors which are detailed from time to time in the Company's filings with the U.S. Securities and Exchange Commission.

A. Executive Overview

Business Description

Elbit Systems operates in the area of upgrading existing airborne, ground and naval defense platforms and is engaged in projects involving the design, development, manufacture and integration of advanced integrated defense systems, electronic systems, electro-optic systems and products and software intensive programs and products for the defense and homeland security sectors. In addition, the Company provides support services for such platforms, systems and products.

The Company is engaged in leading projects in Israel and worldwide, in areas such as air, ground and naval Command, Control, Communication, Computers, Intelligence, Surveillance and Reconnaissance ("C^4ISR") systems, digital maps, night vision systems, pilot helmet mounted systems, display and data processing systems, unmanned air vehicles ("UAVs"), computerized simulators, communication systems, thermal imaging products, laser products, optical systems for space applications, airborne reconnaissance systems, optic communication systems and products, systems for Homeland Defense products, surveillance products and systems and electric drive systems.

The Company provides a wide range of logistic support services, including operation of pilot training services for the Israeli Air Force on a private financing initiative ("PFI") basis. Several of the Group's companies also provide advanced engineering and manufacturing services to various customers, utilizing their significant manufacturing capabilities. The Company often cooperates with industries in Israel and in various other countries.

The Company tailors and adapts its technologies, integration skills, market knowledge and battle-proven systems to each customer's individual requirements in both existing and new platforms. By upgrading existing platforms with advanced electronic and electro-optic technologies, the Company provides customers with cost-effective solutions, and its customers are able to improve their technological and operational capabilities within limited defense budgets.

The Company operates in a competitive environment for most of its projects, systems and products. Competition is based on product and program performance, price, reputation, reliability, maintenance costs and responsiveness to customer requirements. This includes the ability to respond to rapid changes in technology. In addition, its competitive position sometimes is affected by specific requirements in particular markets.

Financial Highlights

The Company's revenues increased by 5.7% and reached $213.7 million in the first quarter of 2004, as compared to $202.2 million in the first quarter of 2003. The main increase in revenues was in the armored vehicles systems area.

Net earnings in the first quarter of 2004 were $12.7 million and the diluted earnings per share were $0.31, as compared to $12.3 million and $0.31 in the first quarter of 2003.

The Company's backlog as of March 31, 2004 reached $1.82 billion, and the Company's cash flow generated from operations in the first quarter of 2004 was $25.3 million.

B. Backlog of Orders

The Company's backlog of orders as of March 31, 2004 reached $1,821 million, of which 64% were for orders outside Israel. The Company's backlog as of December 31, 2003 was $1,752 million, of which 63% were for orders outside Israel.

Approximately 74% of the Company's backlog as of March 31, 2004 is scheduled to be performed in the following three quarters of 2004 and during 2005. The majority of the 26% balance is scheduled to be performed in 2006 and 2007.

C. Critical Accounting Policies and Estimates

The Company's significant accounting policies are described in Note 2 to the audited consolidated financial statements for the year ended December 31, 2003 and in Note 2 to the un-audited consolidated financial statements for the quarter ended March 31, 2004. See also the Company's management report for the year ended December 31, 2003.

D. Sarbanes-Oxley Act

According to Section 404 of the U.S. Sarbanes-Oxley Act of 2002, the Company is required to include in its annual report for 2005 an assessment, as of the end of the fiscal year, of the effectiveness of its internal controls and procedures for financial reporting.

During 2003 and the first quarter of 2004, the Company took steps to assure compliance of its documentation and controls over financial reporting with the guidelines stipulated in the Sarbanes-Oxley Act. The Company plans to continue with these steps during the remainder of 2004 and 2005.

E. New Accounting Standards

The significant accounting policies in the preparation of these statements are identical to those applied in preparation of the latest annual financial statements except as follows:

In January 2003, the FASB issued Financial Accounting Standard Board (FASB) issued Interpretation No. 46, Consolidation of Variable Interest Entities, an interpretation of ARB No. 51 ("FIN 46"). In December 2003, the FASB modified FIN 46 to make certain technical corrections and address certain implementation issues that arose. FIN 46 provides a new framework for identifying Variable Interest Entities ("VIEs") and determining when a company should include the assets, liabilities, non-controlling interests and results of activities of a VIE in the activities of the company's financial statements. The provisions of FIN 46 were adopted as of March 31, 2004. The adoption of FIN 46 did not have significant effect on the Company's financial statements.

F. Employee Stock Option Plan

The change in the Company's share price affected the Company's financial results due to the impact of the employee stock option plan adopted in 2000. The plan was comprised of options for 5 million shares, divided into options to purchase up to 2.5 million shares and an additional 2.5 million "phantom" options. The phantom options grant the option holders a number of shares corresponding to the benefit component of the options exercised, as calculated on the exercise date, in consideration for their par value only, and are considered as a variable option plan. The actual number of options granted as of March 31, 2004 was approximately 4.6 million.

Under U.S. GAAP, the total compensation is computed periodically according to the change in the share price and amortized as compensation expense, or income, based on the vesting period of the options. The amount of the expense related to the stock option compensation in the first quarter of 2004 was not material.

G. Summary of Financial Results

The following table sets forth the consolidated statements of operations of the Company and its subsidiaries for the three-month periods ended March 31, 2004 and March 31, 2003.

	For the three months ended March 31			
	2004		2003	
	$	%	$	%
	(In thousands of U.S. dollars, except per share data)			
Total revenues	**213,672**	100.0	**202,190**	100.0
Cost of revenues	**156,752**	73.4	**145,291**	71.9
Gross profit	**56,920**	26.6	**56,899**	28.1
Research and Development (R&D) expenses	**16,431**	7.7	**15,724**	7.8
Less – participation	**(3,167)**	(1.5)	**(872)**	(0.4)
R&D expenses, net	**13,264**	6.2	**14,852**	7.3
Marketing and selling expenses	**16,409**	7.7	**16,153**	8.0
General and administrative expenses	**11,413**	5.3	**10,984**	5.4
	41,086	19.2	**41,989**	20.7
Operating income	**15,834**	7.4	**14,910**	7.4
Finance expenses, net	**(480)**	(0.2)	**(1,276)**	(0.6)
Other expenses, net	**215**	0.1	**109**	0.1
Income before taxes on income	**15,569**	7.3	**13,743**	6.9
Taxes on income	**4,195**	2.0	**3,646**	1.8
	11,374	5.3	**10,097**	5.1
Minority interest in gains (losses) of subsidiaries	**(5)**	0.0	**257**	0.1
Equity in net earnings of affiliated companies and partnership	**1,358**	0.7	**1,901**	0.9
Net earnings	**12,727**	6.0	**12,255**	6.1
Diluted earnings per share	**0.31**		**0.31**	

First Quarter of 2004 Compared with the First Quarter of 2003

Revenues

The Company's consolidated revenues increased by 5.7%, from $202.2 million in the first quarter of 2003 to $213.7 million in the first quarter of 2004.

The following table sets forth the Company's revenue distribution by areas of operation:

	Three-Month Period ended			
	March 31, 2004		March 31, 2003	
	$ millions	%	$ millions	%
Airborne systems	88.6	41.4	98.9	48.9
Armored vehicle systems	54.6	25.6	32.3	16.0
C^4I systems	29.5	13.8	32.0	15.8
Electro-optics	30.7	14.4	27.2	13.5
Other (mainly non-defense engineering and production services)	10.3	4.8	11.8	5.8
Total	213.7	100.0	202.2	100.0

The decrease in the airborne systems sales was mainly as a result of completion of certain upgrade programs, while new programs are expected to generate revenues in the future.

The increase in the armored vehicle systems revenues of approximately 69% was mainly due to revenues from fire control systems sold for new armored vehicle projects in various countries.

The following table sets forth the Company's distribution of revenues by geographical regions:

	Three-Month Period ended			
	March 31, 2004		March 31, 2003	
	$ millions	%	$ millions	%
Israel	53.9	25.2	50.4	24.9
United States	79.5	37.2	77.1	38.1
Europe	32.1	15.0	21.4	10.6
Other countries	48.2	22.6	53.3	26.4
Total	213.7	100.0	202.2	100.0

The Company's sales are primarily to governmental entities and prime contractors under government defense programs. Accordingly, the level of the Company's revenues is subject to governmental budgetary constraints. The recent economic situation in Israel has created some uncertainty with respect to the Israeli Government's general and defense budgets.

Revenues in Europe increased by 50%, from $21.4 million to $32.1 million. The increase was partly due to consolidating sales of a subsidiary in Europe that was acquired during the second half of 2003 and from other new projects sold to European customers.

Gross Profit

Gross profit in the quarter ended March 31, 2004 was $56.9 million, similar to the quarter ended March 31, 2003. The gross profit margin in the first quarter of 2004 was 26.6%, as compared to 28.1% in the first quarter of 2003 and to 25% in the year 2003.

The Company believes that its average annual gross profit margin for 2004 will not be materially different from its annual gross profit margin in 2003, with possible quarterly variations.

Research and Development ("R&D")

The Company continually invests in R&D in order to maintain and further advance its technologies, in accordance with a long-term plan, based on its estimate of future market needs.

The Company's R&D activities in the reported period were in accordance with its plans. Some of these activities are coordinated with, and partially funded by, third parties, including the Israeli Ministry of Defense ("IMOD") and the Office of the Chief Scientist ("OCS"). These programs were mainly in the areas of advanced airborne systems, cutting edge electro-optics technology and products for surveillance, aerial reconnaissance, lasers and space based sensors. The Company experienced increased IMOD and OCS participation in these programs.

Gross R&D expenses in the quarter ended March 31, 2004 totaled $16.4 million (7.7% of revenues), as compared to $15.7 million (7.8% of revenues) in the quarter ended March 31, 2003.

Net R&D expenses (after deduction of third party participation, including the IMOD and the OCS) in the quarter ended March 31, 2004 totaled $13.3 million (6.2% of revenues), as compared to $14.9 million (7.3% of revenues) in the quarter ended March 31, 2003.

Marketing and Selling Expenses

The Company maintains its activities in developing new markets and pursues at any given time various business opportunities according to the Company's plan.

Marketing and selling expenses in the quarter ended March 31, 2004 were $16.4 million (7.7% of revenues), as compared to $16.2 million (8.0% of revenues) in the quarter ended March 31, 2003.

General and Administrative ("G&A") Expenses

G&A expenses were $11.4 million (5.3% of revenues) in the quarter ended March 31, 2004, as compared to $11.0 million (5.4% of revenues) in the quarter ended March 31, 2003.

The small increase in the G&A expenses was mainly as a result of including the expenses of companies, that were acquired during the second half of 2003.

Finance Expense (Net)

Net finance expense in the quarter ended March 31, 2004 was $0.5 million, as compared to $1.3 million in the quarter ended March 31, 2003.

The decrease in the net finance expense resulted mainly from a lower level of short and long-term loans in the first quarter of 2004 as compared to the first quarter of 2003.

Taxes on Income

Provision for taxes in the quarter ended March 31, 2004 was $4.2 million (effective tax rate of 26.9%), as compared to a provision for taxes of $3.6 million (effective tax rate of 26.5%) in the quarter ended March 31, 2003.

The Company's tax rate represents a weighted average of the tax rates to which the various companies in the Group are subject. The change in the effective tax rate is attributable mainly to the mix of the tax rates in the various tax jurisdictions in which the Group's companies generating the taxable income operate.

Company's Share in Earnings of Affiliated Companies and Partnerships

In the first quarter of 2004 the Company had net income of $1.4 million from its share in earnings of affiliated companies and partnerships, as compared to $1.9 million in the first quarter of 2003. These companies, in which the Company holds 50% or less in shares or voting rights and are therefore not consolidated in its financial statements, operate in complementary areas related to the Company's core business areas, including electro-optics and airborne systems.

The Company's share in Earnings of Affiliated Companies and Partnerships in the first quarter of 2004 includes expenses related to commercial airborne wide band communication activities in a newly incorporated affiliate company ("Starling").

The Company believes that its affiliates will continue to contribute significantly to the Company's earnings.

Net Earnings and Earnings Per Share ("EPS")

Reported net earnings in the quarter ended March 31, 2004 were $12.7 million (6.0% of revenues), as compared to reported net earnings of $12.3 million (6.1% of revenues) in the quarter ended March 31, 2003. Diluted EPS in the quarters ended March 31, 2004 and 2003 were $0.31.

The number of shares used for computation of diluted EPS in the quarter ended March 31, 2004 was 40,718 thousand shares, as compared to 39,793 thousand shares in the quarter ended March 31, 2003. The increase in the number of shares was mainly due to exercise of options during 2003 and the first quarter of 2004.

H. Liquidity and Capital Resources

The Company's cash flows are affected by the cumulative cash flows of its various projects in the reported periods. Project cash flows are affected by the timing of the receipt of advances and the collection of accounts receivable from customers, which relate to specific events during the project, while expenses are on-going. As a result, the Company's cash flows may vary from one period to another.

The Company's policy is to invest its cash surplus primarily in interest bearing deposits in accordance with its projected needs.

The resources available to the Company include mainly profits, collection of accounts receivable, advances from customers, as well as Government of Israel grants and participation and bank financing in Israel and elsewhere based on its capital, assets and activities. In addition, the Company has the ability to raise funds through the offering of shares and debentures to the public from time to time.

The Company's net cash flows generated from operating activities in the quarter ended March 31, 2004 were $25.3 million, resulting mainly from net income for the period and collection of accounts receivable. The cash inflows were partially offset, mainly by payments of trade payables.

Net cash flows used for investment activities in the quarter ended March 31, 2004 were $10.3 million, which were used mainly for procurement of property, plant and equipment. The investments were made primarily in equipment for the Group's various manufacturing plants and in a building being constructed at Elbit Systems' facility in Haifa, Israel. The building is planned to house employees currently located in various leased locations in the industrial park in Haifa, and the Company plans to complete its population during 2004.

Net cash flows used for financing activities in the quarter ended March 31, 2004 were $0.9 million, reflecting $3.6 million in proceeds from the exercise of options and repayment of short and long-term borrowings.

On March 31, 2004, the Company had total borrowings in the amount of $66.1 million, including $59.1 million in long-term loans, and $417 million in guarantees issued on its behalf by banks, mainly in respect of advance payment and performance guarantees provided in the regular course of business. On March 31, 2004, the Company had a cash balance amounting to $90.3 million.

As of March 31, 2004, the Company had working capital of $202.4 million and its current ratio was 1.56. The Company's ratio of equity to total assets was 46.3%.

I. Derivatives and Hedges

Market risks relating to the Company's operations result primarily from changes in interest rates and exchange rates. The Company typically uses financial instruments to limit its exposure to those changes. The Company also typically enters into forward contracts in connection with transactions that are denominated in currencies other than U.S. dollars and New Israeli Shekels ("NIS"). The Company may enter from time to time into forward contracts related to NIS, based on market conditions.

On March 31, 2004, the Company's liquid assets were comprised of bank deposits, and it had no investments in liquid equity securities that were subject to market fluctuations. The Company's deposits and loans are based on variable interest rates, and their value as of March 31, 2004 was therefore not exposed to changes in interest rates. Should interest rates either increase or decrease, such change may affect the Company's results of operations due to changes in the cost of the liabilities and the return on the assets that are based on variable rates.

The Company's functional currency is the U.S. dollar. On March 31, 2004, the Company had exposure due to liabilities denominated in NIS of $64 million in excess of its NIS denominated assets. These liabilities represent mostly wages, trade payables and the debt to the OCS resulting from the OCS agreement entered into in 2002. (See Note 16 to the audited consolidated financial statements for the year ended December 31, 2003). The amount of the Company's exposure to the changes in the NIS-U.S. dollar exchange rate varies from time to time. On March 31, 2004, the Company had options covering future cash flows in the amount of $84 million.

Most of the Company's assets and liabilities which are denominated in currencies other than the NIS and the U.S. dollar were covered as of March 31, 2004 by forward contracts. On March 31, 2004, the Company had contracts for the sale and purchase of such foreign currencies totaling $21.9 million. The results of financial derivative activities in this quarter were not material.

J. Dividends

The Board of Directors declared on May 10, 2004 a dividend of $0.11 per share.

* * *